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LEGAL AID SOCIETY OF DAYTON, INC.

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GARY J. WESTON
Executive Director

April 6, 1999

Office of Fiscal Assistant Secretary
U.S. Department of the Treasury
1500 Pennsylvania Ave. N.W. Room 2112
Washington, D.C. 20220

re: Comments of the Edgemont Neighborhood Coalition to RIN 1505-AA74; Possible regulation Regarding Access to Accounts at Financial Institutions through Payment Service Providers

Dear Sir/Madam:

Edgemont Neighborhood Coalition, Inc. is a nonprofit community organization located in Dayton, Montgomery County, Ohio. The group consists of residents of the Edgemont neighborhood, a low-income African American neighborhood in Dayton, who have associated in order to foster pride in their neighborhood and address the issues of crime, youth and adult joblessness, inadequacy of educational opportunities, affordability of utilities, and business and community development. In addition to being a community organization, Edgemont Neighborhood Coalition, Inc. functions as a small business, operating an office, storefront, community garden and community computer center.

Our neighborhood has been involved in Electronic Funds Transfers since 1992. Our area was part of a pilot project to use a "smart card" (off-line technology) to deliver Food Stamps electronically in portions of Montgomery County. The "smart card" pilot is now being expanded to the entire State. We have been concerned that neighborhood residents be treated fairly as EFT systems are developed.

The Department of the Treasury has asked whether it should regulate arrangements between banks receiving Electronic Fund Transfer deposits from the Treasury and "nondepository payment

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service providers" such as check cashing services. These latter organizations are often referred to as "fringe bankers" because they serve and exploit people on the social and economic fringes of society who are denied access to mainstream credit at mainstream prices.

The Department should prohibit these relationships in order to protect recipients of Federal Transfer Payments against exploitation by fringe bankers. Many potential victims of fringe bankers receive some form of transfer payment from government, which is increasingly likely to be delivered electronically. The federal government can either be a pipeline of profit to those who exploit low income communities, or it can be the engine of bringing the poor into the financial mainstream.

The changes in welfare laws are bringing many of the poor into the working mainstream. However while poor people are working and therefor earning more, their earnings are being taken from them by the exploitative practices of the "fringe bankers" who provide financial services in an economically segregated market.[1]

In Ohio, special legislation allows check cashing services to make "payday loans" at a rate of 5% interest per month (60% per year).[2] When origination fees are added in, the "annual percentage rate" of a typical payday loan is a staggering 400%.[3] A typical borrower writes a postdated check for $230, payable on his next payday less than two weeks away, and exchanges it for $200 from the lender. On payday, either the borrower redeems the check or the lender puts it through the borrower's account. If

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[1] For general information on this topic, see John P. Caskey, Fringe Banking: Check Cashing Outlets, Pawnshops and the Poor (Russell Sage Foundation 1994); Jean Ann Fox, Consumer Federation of America, the Growth of Legal Loan Sharking: A Report on the Payday Loan Industry (November 1998); "Poverty Inc.," Consumer Reports, July 1998.

[2] Ohio Revised Code §1315.39(B). See generally Ohio Revised Code §1315.35 to 1315.42.

[3] Prior to legislation allowing check cashers to make high interest loans, the legally allowable interest rate for a loan of under $1000 was 28%, under Ohio's "Small Loan" Act, Ohio Revised Code §1321.13(A).

the money is not there, the borrower is subject to bad check fees, the threat of criminal prosecution, and frequently suits for triple damages under an Ohio law providing triple damages for victims of crime.[4]

Although Ohio's payday loan statute provides for a conspicuous warning in large print telling the customer that the loan charges higher interest than the average interest charged by financial institutions on similar loans, borrowers sign the agreements in large numbers. Borrowers do not protect themselves well against these loans. The primary reason is structural. Desperate borrowers don't have any financial cushion and must survive today, even if they must pay an exorbitant cost. They are always vulnerable to payments that are manageably low, even if comparatively unfavorable in the long run. The underlying problem is that the poor are denied access to mainstream credit and are unwelcome or hassled in regular banks. Check cashers market themselves in areas where banks do not. They also advertise on television at times when low income people are likely to be watching.[5] Their hours and locations are convenient, and they make customers welcome. They constitute what is effectively a segregated market in which much higher rates can be charged.

A serious problem with payday loans is that they are a gateway to bankruptcy. Legal Aid Society of Dayton has seen numerous clients who have become hooked on payday loans, sometimes having several pending at once from different lenders. It is impossible for someone to get out of debt because of the high interest and quick turnover of the loans. A likely outcome is that consumers will

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[4] Ohio Revised Code §O.R.C.1. Since the law traditionally provides that a postdated check is nothing more than a promise to pay in the future, and since both lender and borrower know that the borrower has no money at the time the loan has made, it is questionable whether failing to deposit enough to cover a postdated payday loan check is a "crime" justifying the award of triple damages. However many borrowers do not contest suits for triple damages, and Ohio courts, to our knowledge, have not ruled on the issue.

[5] Edgemont's president recently saw a TV commercial for payday loans in which dollars were swirling around the head of a happy borrower. This unfortunately is not the full picture of payday loans.

roll small loans over into larger ones, a practice known as "flipping," which allows the customer to be squeezed unmercifully for a longer period before destitution and bankruptcy finally occur.

Despite the financial crashes that they cause among vulnerable customers, the high interest rates make them extremely profitable.[6] The volume of payday loans is expanding rapidly in states where they are available. The check cashers are increasingly sophisticated politically, and adept in securing favorable legislative treatment.

Payday loans drain money from those unfortunate enough to need them, and transfer it to the lenders. Their overall effect is to impoverish communities which need to build their wealth, and to prevent local businesses from being able to thrive.

Unfortunately, the state laws that are passed are generally favorable to lenders and do not do a good job of protecting borrowers. The realities of campaign finance make it difficult for legislation to fairly balance the interests of wealthy businesses and consumers. Of particular concern are the connections between fringe bankers and mainstream bankers, which are evidenced by the relationships being considered in this regulation.[7] This allows them to play both sides of a segregated market, and indirectly charge exorbitant rates to customers they refuse to serve directly.

The government has the opportunity to use EFT as Community Reinvestment tool to promote the provision of mainstream financial services to the recipients of federal benefits. Allowing relationships between banks and check cashers would promote a segregated financial services market by allowing lenders to shunt low income customers to check cashers. The banks

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[6] Jean Ann Fox, Consumer Federation of America, the Growth of Legal Loan Sharking: A Report on the Payday Loan Industry pp. 3-6 (November 1998).

[7] Joint Comments by the National Consumer Law Center and the Consumer Federation of America are expected to document an increasing number of relationships. An ominous development is an ATM card program Citibank has with the National Association of Check Cashers of America.

benefit by not having to serve the low income market directly, while check cashers get a flow of captive potential customers to whom they can sell payday loans and other overpriced services. However the community as whole does not benefit, because the poor are made poorer due to their segregation from the financial mainstream, which the Treasury Department would be facilitating.

Ultimately the solution to this problem is to expand the availability of reasonably priced, non-abusive financial services to the poor. If banks will not do this then other institutions such as Community Development Credit Unions should do so. The government should support efforts to develop reasonably priced financial services to the poor, and not aid in their exploitation.

Thus the government should regulate the ability of banks to shunt the poor to check cashers. At present, the best action would be to prohibit all such relationships. There does not seem to be any way that the Treasury can realistically limit the abusive practices in the check cashing industry at this time. If check cashers are allowed into the system through the back door, thousands will be victims.

The Consumer Federation of America has model payday loan legislation designed to curb abuses for excessive fees, roll-over of loans and punitive collection practices. CFA suggests requiring that checks taken as collateral for payday loans be stamped as "deferred deposit," that interest rates be limited to those normally charged in small loans, that repeat loans and any unconscionable or deceptive practices be prohibited, and that aggrieved borrowers have full access to the Courts for redress. In the event that such meaningful standards someday became the norm, the Department could consider revisiting the issue.

Thank you for your consideration.

Truly yours,

Stanley A. Hirtle

Stanley A. Hirtle
Attorney at Law

cc: Edgemont Neighborhood Coalition

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